

No. 15,950
United States Court of Appeals
For the Ninth Circuit

BIDART BROS., a corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the
Southern District of California,
Northern Division.

Honorable Gilbert H. Jertberg, Judge.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

Comes now Bidart Bros., a farming corporation, having its principal place of business in Saco, Kern County, California, and appeals to the above-entitled Court from a decision of the United States District Court, Southern District of California, Northern Division, denying appellant the right to recover certain income tax monies which appellant claims are the result of an illegal assessment by the Director of Internal Revenue.

PLEADINGS AND FACTS SHOWING JURISDICTION.

The case involves a claim for refund of income taxes paid under protest as a deficiency assessment by the District Director, United States Treasury Department, Internal Revenue Service, R. A. Riddell [3].

The District Court has jurisdiction of the action by virtue of the provisions of Title 28, *U.S.C.A.* §1346 (a) (1) and Title 26, *U.S.C.A.* §7422.

Findings of Fact, Conclusions of Law and Judgment were signed by Judge Jertberg, judge of the United States District Court, Southern District of California, Northern Division, on January 9, 1958, and Judgment was entered on said day [31-35]. Notice of Appeal was timely filed on February 10, 1958 [36]. Bond for costs on appeal and Designation of Contents of Record on Appeal were also filed, giving this Court jurisdiction of the appeal under the provisions of Title 28, *U.S.C.A.* §1291 and §1294, since the question involved does not concern a situation embracing a direct appeal to the Supreme Court as authorized by §1252 and §1253 of Title 28, *U.S.C.A.*

STATEMENT OF THE CASE.

The Complaint alleges that the plaintiff returned and filed with the Department of Internal Revenue its Income Tax Return for the period May 1, 1951, to April 30, 1952. Said Return, among other things, dealt with crops growing on leased land, which plain-

tiff had held, owned and occupied for more than six months, and which plaintiff sold with said growing crops to one and the same party in one and the same transaction. In the Return above mentioned plaintiff treated the transaction as a single transaction and as a long-term capital gain. The Director of Internal Revenue in auditing the Return levied a deficiency assessment in the amount of \$107,258.90 by denying capital gains treatment to the growing crops upon said leased lands, segregating the crops, and by treating the profit alleged to have been attributed to the crops as ordinary income [1-5].

The Answer admitted [10-11] and the Findings of Fact found the allegations of the Complaint true [31-34].

As Conclusions of Law the Court found that plaintiff had not sustained its burden of proving that the gain on the sale of unharvested crops on leased land came under the provisions of §117 (j) (3) of the Internal Revenue Code; that a leasehold estate for years is not "land" within the meaning of the section; that plaintiff was entitled to no refund, and entered judgment accordingly [34-35].

ASSIGNMENTS OF ERROR.

1. The legal sufficiency of Conclusions of Law II, III and IV is challenged.

2. The Judgment is against law for the reason that under the Findings of Fact plaintiff should be entitled to the relief prayed for.

LEGAL QUESTIONS INVOLVED.

The Assignments of Error raise the following legal matters:

1. Growing crops on leased land which has been held, owned and occupied for more than six months, which is sold with said growing crops to one and the same party in one and the same transaction, are entitled to capital gains treatment rather than to ordinary income treatment, by virtue of the provisions of §117 (j) (3) of the Internal Revenue Code, as amended in 1951.

2. Treasury Department Regulation 111, paragraph 29.117, being contradictory to the plain meaning of the statute, is invalid and void.

ARGUMENT.

POINT I.

HISTORICAL BACKGROUND.

Prior to 1951 the Internal Revenue Act, Section 117 (j) dealing with the sale or exchange of properties used in trade or business provided:

“(j) Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business

(1) Definition of property used in the trade or business. For the purposes of this subsection, the term ‘property used in the trade or business’ means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for

more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General rule.* If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.”

While the Act was in this status sales of land with crops growing thereon presented problems in respect to whether the crops growing upon the land were subject to capital gains treatment or to ordinary income treatment. The Tenth and Fifth Circuit Courts in discussing the problem held the crops to be subject to capital gains treatment. In *McCoy v. Commissioner*, 192 Fed. 2d 486 (10th Circuit) the Court held a growing crop of wheat sold with the land, which had been held for more than six months, to be entitled to capital gains treatment. In *Owen v. Commissioner*, 192 Fed. 2d 1006 (5th Circuit), the Court held that a crop of oranges partially grown upon the land, which had been held for more than six months and sold together with the crop, was entitled to capital gains treatment. In *Watson v. Commissioner*, 197 Fed. 2d 56 (9th Circuit), a crop of oranges growing upon land held for more than six months and sold was held to be subject to segregation and the price attributable to the land entitled to capital gains treatment and the price attributable to the crop to treatment as ordinary income.

This condition was called to the attention of Congress, which in 1951 amended Section 117 (j) by adding a paragraph (3), which reads as follows:

“Sale of land with unharvested crop. In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2) (at the same time and to the same person, the crop shall be considered as ‘property used in the trade or business.’ ”

Prior to the addition of §117 (j) (3) the policy of the Commissioner was “ ‘upon the sale of a going business it (the sales price) is to be comminuted into its fragments, and these are to be separately matched against the definition in §117 (a) (1) . . .’. It is consistent also with the policy of the Bureau of Internal Revenue and the Tax Court, dating, at least, from the statement made by the Bureau in 1946, that, under circumstances comparable to those before us, ‘regardless of their stages of development, any gain realized from the sale of growing crops is ordinary income.’ ”

After the amendment adding §117 (j) (3) the Treasury Department promulgated Regulation 111, Paragraph 29.117, which reads in part “. . . a leasehold or estate for years is not ‘land’ for purposes of this section.”, and based upon its regulation has continued to segregate the land and the crops in the event of a pertinent sale, and to treat the increment of the crops as ordinary income, its theory being that since a leasehold estate, as distinguished from a fee simple title, is not considered an estate in freehold and as such entitled to treatment for purposes of

conveyance, inheritance and probate, as real estate, but on the other hand is merely an estate for years, and as such entitled to treatment only as personal property, or as a chattel real. *Footnote, 97 Law Ed. 1241.*

Whether the Department is entitled to uphold such a construction is the sole and only point before this Court. It is submitted that the construction of the Department and the position of the defendant before this Court in upholding the Department is unsound because:

1. It is contrary to the plain language of the amendment to the 1951 Act.

2. The construction, in effect, confuses "land" with "land tenure."

3. The construction of the Department and the position of the defendant here are contrary to the legislative intent, which appears in the legislative history of the Act, contained in Senate Report No. 781, issued September 18, 1951, and in the debates in reference to the Act, contained in Congressional Record, Volume 97, at pages 11811, 11814 and 12376.

4. Since the position of the Department and of this defendant is contrary to the plain meaning of the statute and to the express Congressional intent, it is void.

POINT II.

THE INTERPRETATION OF THE DIRECTOR IS CONTRARY TO THE PLAIN LANGUAGE OF THE AMENDMENT TO THE 1951 ACT.

Assistance can be gained by paraphrasing portions of Section 117 (j) (3):

1. “. . . in the case of an unharvested crop on land used in the trade or business and held for more than six months.” There is no question here that the crop was unharvested at the time of the transaction. Necessarily, therefore, it had to be growing upon land, for land is the only place upon or in which a crop might grow.

2. “. . . land used in the trade or business and held for more than 6 months.” The leases involved had been held for a period of 5 to 8 years, and were used in the business of farming of plaintiff.

3. “. . . if the crop and the land are sold . . . at the same time and to the same person.” The stipulated facts accept this feature of the section. The transaction was a unit transaction between plaintiff and Wheeler Farms, a copartnership. A copartnership, corporation or other legal entity has been uniformly held in the eyes of the law to be a “person.” It is obvious that this portion of the section has been complied with.

4. To further paraphrase “. . . the crop shall be considered as ‘property used in the trade or business.’ ” Section 117 (j) (1), in existence before and since the amendment adding 117 (j) (3), dealt with the definition of “property used in trade or business.” It had two requirements:

(a) Of a character subject to depreciation of real property; and

(b) Held for more than six months.

Section 117 (j) (3), in effect, has added a third specie of property which shall be considered "property used in the trade or business." The first two specie of property mentioned in Section 117 (j) (1) are subject to the following limitations:

(a) Property of a kind which would properly be includible in the inventory, if on hand at the close of the taxable year; and

(b) Property held primarily for sale to customers in the ordinary trade or business.

Neither of these exclusions can by any stretch of the imagination apply, because a growing crop would not be inventoried, and growing crops are not the subject of sale in the ordinary course of business, rather, only matured crops are so subject.

The clear and plain meaning of the amendment is to state that if the land is used in the ordinary trade or business, and held for six months, and is the subject of a sale in a single transaction which includes the crop growing thereon, the transaction is a single transaction, indivisible, and is subject to capital gains treatment as provided in Section 117 (j) (2), which is the identical treatment used by the plaintiff taxpayer and contested by the Department and Government.

POINT III.

THE CONSTRUCTION, IN EFFECT, CONFUSES
"LAND" WITH "LAND TENURE".

It is to be noted that Section 117 (j) (3) when passed was made applicable to tax years beginning after December 31, 1950 (1951) Internal Revenue Act, Section 323 (c). The Regulation relied upon by the Government is Regulation 111, Par. 29.117, which was promulgated February 3, 1953, three years after the effective date of the amendment. Just how the Department is qualified, by a promulgation, contrary to the express intent of Congress, to make it retroactive for over a period of three years, is difficult of comprehension.

The pertinent part of the Regulation relied upon by the Government (referring to Section 117 (j) (3)) is ". . . a leasehold estate for years is not 'land' for the purpose of this section." If it is anything more than a statement "black is white," it amounts to an attempt to confuse "land" with "land tenure." The word "land" is the solid material matter of which the earth is constructed, and is one of the three basic elements composing the world, the other two being water and atmosphere. Such is the definition given in Webster's New International Dictionary, 2d Edition:

Land is 'the solid part of the surface of the earth as distinguished from water constituting a part of such surface.'

Webster gives as the law definition of land:

"any ground, soil, or earth whatsoever regarded as the subject of ownership . . ."

“an interest or estate in land, loosely a tenement or hereditament.”

Webster's definition of a leasehold:

“a tenure by lease on the land held; specifically land held as personalty under a lease for years.”

It is that which is the subject of ownership, in varied forms. One's ownership in land may be absolute, such as fee simple, or fractionally absolute, such as tenancy in common. The character of this tenure is the right to the possession of the whole, either solely or in conjunction with others, unabridged by time, that is to say, in perpetuity.

There are lesser degrees of land tenure, life estates, for instance, which contemplate absolute possession but limited in continuity to the life of the life tenant. Land tenure is further delineated in perpetuity by another method, namely, a given number of days, months or years, and a system of land tenure is characterized as leasehold and dealt with in the law as a chattel real, whereas the other measures of land tenure dealt with in law are commonly characterized as real property. This characterization is a misnomer at most and amounts to nothing more than one character of land tenure as distinguished from another. This distinction is recognized in legal treatises. Webster defines a leasehold as “a tenure by lease on the land held.”

Ballentine's Law Dictionary defines land as “a word which includes not only the soil, but everything attached to it, . . .”, and leasehold as “an estate in

real property which is conveyed to a tenant by his landlord when the landlord makes a lease of the property to the tenant. This leasehold estate is then in law entirely separate and distinct from the estate which the landlord retains."

It follows, therefore, that since the language of Section 117 (j) (3) uses the word "land" without any distinction between varying methods of land tenure or estates in land, the purported Regulation which seeks to inject into the definition of "land" certain methods of land tenure, to the exclusion of others, is to that extent directly contrary to the plain and unambiguous language of the Revenue Act in question.

POINT IV.

THE CONSTRUCTION OF THE DEPARTMENT AND THE POSITION OF THE DEFENDANT HERE ARE CONTRARY TO THE LEGISLATIVE INTENT.

The legislative history, Senate Report 781 of September 18, 1951, contains the following discussion, from which it will be noted that the position of the Bureau and of the cases were before the Committee. It considered the position of the Bureau that growing crops constituted property primarily held for sale to customers and therefore entitled to separate treatment, it is also noted that the Committee had before it the conflicting views of the various circuits, previously noted. It concludes:

"Your committee believes that sales of land together with growing crops or fruit are not such

transactions as occur in the ordinary course of business and should thus result in capital gains rather than in ordinary income.”

Senator George made the following comment:

“Mr. President, the committee bill provides that where land is sold together with the unharvested crop or fruit upon such land, the gain resulting from such sale shall be treated as a capital gain. Under existing law, there is uncertainty and litigation as to whether the gain from the sale of the crop must be determined separately and treated as ordinary income or whether the entire gain is a capital gain. It is provided in the bill that in such cases no deduction shall be allowed with respect to the expenses attributable to the production of the unharvested crop but that such expenses shall be included in the cost of the crop in determining the amount of the gain, that is, in arriving at a proper base upon which to tax a capital gain.”

The report of the Senate Committee was accepted by the House in the Conference Report:

“This amendment provides rules for the application of Section 117 (j) in cases where land bearing an unharvested crop is sold. The provision applies in cases where the land has been held for more than 6 months. The period that the crop has been on the land is immaterial. The House recedes.”

On September 21, 1951, Senator Humphrey in debating the Revenue Act of 1951 on the Senate Floor makes the following statement, recorded in Volume 97, Congressional Record, Part 9, at page 11811:

"Of course, if we are to extend treatment like this to ordinary property used in the conduct of a business, then we have to extend it to the livestock people, to the turkey people, and I see no reason why we should not extend it to others.

Our basic problem in taxation is equality of treatment of those similarly situated. The farmer who disposes of property used in his business should not be taxed differently from the manufacturer or merchant who does the same thing."

And, further, quoting from page 11814, given by the same senator on the same day:

"If we are to give capital gains treatment to an unharvested crop, I submit we should give capital gains treatment to every farmer who harvests his crop. The same kind of treatment should be given to every farmer."

And Senator Holland, on September 28, 1951, made the following remarks, recorded in the Congressional Record, Volume 97, at page 12376:

"Mr. President, there are many good features in this bill which have not been commented upon. I am sorry that the time limitation prevents me from doing any more than to call attention to a provision which I have not heard mentioned and that is the change of the capital gains tax as it applies to a citrus grove, an apple orchard, or any other farming property in this nation when it is sold, after ownership of more than 6 months, as a property with an unharvested crop on it.

Under the very unwise rulings, it seems to me, of the Internal Revenue Bureau, such a sale has been regarded as a double sale, and the tax au-

thorities have forced a division which did not exist at all in the minds of those who made the sale and the purchase—an artificial division of the sale of the real estate from the sale of the unharvested crop. Under the amendment which is placed in the bill, if the property has been held 6 months that result will no longer be permitted, but, instead, the sale will be treated just as it has actually existed, as a single sale of a developed property with a feature on it, an unharvested crop, which entered into that single sale without the artificial handling required in some jurisdictions under the present rule, which, by the way, is not uniformly approved by the courts. Some courts have approved the rule of the Internal Revenue Bureau and some have frowned upon it. *The result of the amendment is to make uniform this matter and to give a fair deal to our agricultural people all over the nation.*

I call attention to the fact, Mr. President, that this is a matter which does not generally concern the very rich people. *This is something that applies to the farmers, small and large, who will be permitted to sell their properties now with security, whereas they have been denied that security under the law as it is now mistakenly enforced.*”

The foregoing discussions bring into focus the following propositions:

1. That Congress was aware of the conflicting decisions in respect to the treatment of growing crops.
2. That Congress considered the position of the Department of Internal Revenue as discriminatory.

3. That Congress intended the amendment to apply to farmers of all kinds, both large and small, rich and poor.

4. That Congress was concerned with the proposition of whether the crop was mature or immature, and not with the length of time it had been growing or the degree or stage of its maturity.

5. That Congress was not concerned with the character of tenure under which the land was occupied by the farmer.

6. That Congress foresaw that there were "pit-falls" in fee land transactions as great as in leased land transactions, and guarded against the same by providing that such transactions, whether in leased land or in fee land, were entitled to treatment only as ordinary income if the transactions were of such a character that the taxpayer held the same primarily for sale to customers in the ordinary course of his trade or business.

POINT V.

CASES CONSTRUING THE AMENDMENT.

There is no enlightening case law dealing with the amendment, but two cases reported since the amendment, dealing with conditions existing before, have noted the amendment.

The case of *Watson v. Commissioner*, supra, reached the Supreme Court in 1953 and was affirmed by a divided Court of six to three, the three dissenters being presently upon the bench and three of the ma-

jority as well. Justice Minton states (97 Law Ed. 1243):

“In amending the Revenue Act of 1951 Congress took cognizance of the construction placed upon Section 117 (j) (1) by the Commissioner and the Tax Court and amended the section to make it abundantly clear that unharvested crops were a part of the land upon which they were grown and were to be given special capital gains treatment.”

And further commenting upon the Committee Report he quotes:

“Your Committee believes that sale of land together with growing crops or fruit are not such transactions as occur in the ordinary course of business and should thus result in capital gains rather than in ordinary income.”

And further:

“Congress was correcting a misinterpretation of the Revenue Act by the Commissioner and the Tax Court.”

Smith v. Cole, 218 Fed. Rep. 2d 667, decided by the 9th Circuit in 1955, also dealt with the Act before the amendment. In that case the majority of the Court reversed the Trial Court because it made no specific finding on the value of the crop of immature oranges as of the date of the sale to the son, and suggested that “some value” be given it under the rule of the *Watson* case. This case also had a dissenter, Justice Healy, who stated:

“There was no basis in fact for ascribing any value to the growing oranges at the time the orchard was sold.”

POINT VI.

SINCE THE POSITION OF THE DEPARTMENT AND OF THIS DEFENDANT IS CONTRARY TO THE PLAIN MEANING OF THE STATUTE AND TO THE EXPRESS CONGRESSIONAL INTENT, IT IS VOID.

The rule is well settled that where an executive department is authorized to make rules of procedure the rules so made are subject to the requirement that they enforce the spirit of congressional legislation, and when they fail to do so or are contrary to the express congressional intent, they are void. *Hagger v. Helvering*, 308 U. S. 389, 60 Sup. Ct. 337 (1940), 54 Harvard Law Review 377; *Sanford v. Commissioner*, 308 U. S. 39, at 53 (1939), 84 L. Ed. 20; *Barnett v. Chicago Portrait*, 285 U. S. 1, at 16 (1932); *Dragoon v. U. S. A.*, 144 Fed. Sup. 188 (1957); *Scofield v. Lewis*, 251 Fed. Rep. 2d 128.

 POINT VII.

THE OPINION OF THE COURT BELOW IS ERRONEOUS.

In the Court's memorandum [18 to 30] great stress was made in respect to the question of whether "land" could be classified as "real property" or "personal property." The Court concluded that "ownership" of the land was an essential element of bringing a transaction involving an unharvested crop within the purview of Section 117 (j) (3) of the Revenue Code of 1939. We are all agreed that the term "land" refers to "the solid substance of the earth."

The opinion of the Court overlooks the fact that "the solid substance of the earth" may be owned or

possessed in varying ways, from a tenancy at sufferance up through the more permanent degrees of land tenure, including estates for years, for life, and fee simple.

The opinion also overlooks the fact that a complete ownership of the entire fee in land is not a prerequisite to a sale.

“Sale,” according to Webster’s Dictionary, is defined as:

“The act of selling, the exchange of property of any kind, or of some services, for an agreed sum of money or other valuable consideration; a contract made for the transfer of property.”

Taking the opinion at its face value, to-wit, that the entire fee in land is a prerequisite to a “sale” of “land,” it could easily be argued that such a transaction would be a physical impossibility, because even land owned in “fee” does not embrace entire “ownership.” Would land subject to a mortgage be excluded? Would land sales under contract be excluded where a balance remains unpaid? How could the land be divorced from a lien for taxes, which affixes itself in March and is not payable until October? Would the Court only consider sales involving the entire ownership of land sales between October (after the taxes were paid) and March (before the next year’s tax became a lien)? Suppose the land were subject to an improvement assessment due over a number of years; would such transactions be ruled out? Obviously, a “sale” of “land” according to the common understanding of the term, is not so con-

fining, but rather it embraces the estate, whatever it may be, which the occupant has in the land, whether that estate be considered an estate in freehold and classified for certain purposes as "real property," or whether it be considered a chattel real and classified for certain purposes as "personal property."

It is further submitted that the emphasis given by the Court to the word "land" is contrary to the spirit of the Act as a whole.

Furthermore, Section 117 (j) was adopted in 1938 and was given the broad title "Capital Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business." Subdivision (1) contains a definition. It reads:

"Definition of Property Used in the Trade or Business. For the purposes of this section the term 'property used in trade or business' means property used in the trade or business of a character which is subject to the allowance for depreciation provided in *Section 23 (1)* held for more than 6 months, and *real property* used in the trade or business held for more than 6 months which is not (a) property includable in inventory, etc. . . . (b) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

The type of property subject to allowance for depreciation provided for in Section 23 (1) is:

"A reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade

or business, or (2) property held for the production of income."

The word "property" is defined in Webster's as:

"Any property, real or personal, which the owner has the right to control, use and dispose of, as he will; . . . something being possessed."

and

"A specific piece of land or real estate."

The Revenue Code stressed not whether the article involved was of such a character as to be considered real or personal, but it was concerned with (1) the business use thereof, and (2) whether the property used in the business was primarily for sale to customers in the ordinary course of business. The controversy which resulted in the adoption of Section 117 (j) (3) arose because of the Treasury Department's regulation that growing crops constitute property held by a farmer for sale to customers in the ordinary course of trade or business, and for that reason were excluded from capital gains treatment—not for the reason that the crop might be growing on leased lands, as distinguished from lands held under other forms of tenure. By the addition of "(j) (3)" the Act itself differentiates between *land* and *real property*.

It is true that the cases which presented the problem at the time it was considered by Congress all, by coincidence, dealt with sales of freehold estates in land, although *Watson v. Commissioner* covered the sale of an undivided interest in the fee. In none of

the cases was the question of the quantum or degree of interest in the land discussed. The controversy centered around the proposition of whether the immature crop was primarily held for sale to customers in the ordinary course of business and was therefore excluded. Such was the ruling in *Watson*.

In *McCoy v. Commissioner* and in *Owen v. Commissioner* this argument was rejected upon the theory that the law of the State determined the status of the crop, and both the law of Kansas and the law of Florida regarded growing crops as part of the land, which would pass with a conveyance of the land or an interest therein, unless specifically reserved. Both of these cases refer to a sale of the land and use the term "land" and the term "real estate" interchangeably.

California has the same rule, namely, crops until severed are a part of the land and pass with the transfer of any estate in land unless specifically reserved. The Congressional Debates and Committee Reports indicate that Congress considered both of these views and adopted the view, contrary to the ruling of the Commissioner, that if the crop was sold in a transaction the character of which would include the crop, except for a reservation, then there was a single transaction and it was improper to segregate the crop from the land. That is the plain meaning of Section 117 (j) (3). There is no additional language in the section to indicate that the estate in the land must be of any particular quantity or degree of dignity. The California cases cited in the Court's

Memorandum do not support the proposition for which they were cited, to-wit:

“The following citations from the State of California indicate that leases or estates for years do not come within the term ‘land’ ”

Kreling v. Walsh, 77 C.A. 2d 821, does not discuss “land” in any way; it merely makes the statement that a leasehold estate in land is a chattel real. On the contrary, it affirms plaintiff’s position that a leasehold estate is an estate in land.

Jeffers v. Easton, 113 Cal. 345, at 351, is directly against the contention for which it is cited, and it is direct authority for the proposition that an assignment of a lease is in effect a “sale” of a leasehold estate in land. Consider the following language:

“Counsel for appellants argued the case mostly upon the theory that the relation of landlord and tenant existed between the plaintiffs and the corporation respondent. But there was no such relation. The assignment was of the whole term; there was no underletting—no interest left in the assignors; and the relation was simply that of seller and purchaser.”

And, further:

“There is a marked difference between *things real* and an interest or *estate* in things real; the nature of the thing itself, therefore, does not determine the character of any particular estate that may exist in it, whether personal or real, but the extent and duration of the estate.”

The Opinion correctly approaches the problem of attempting to look to the State of California for a

definition of "land" in the absence of a specific definition thereof in the Revenue Act, and the California definition of land is "the solid material of the earth," as is noted by the Opinion, and has nothing whatsoever to do with the estate by which the land may be held. Whatever the estate in land may be, it is a property right in land, whether it be considered a chattel real or real property in the light of the old Common Law rule.

§654 of the Civil Code provides:

"Property, what. The ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others. In this code, the thing of which there may be ownership is called property."

§658 provides:

"Definition of real property; severance by agreement.

Real or immovable property consists of:

1. Land;
2. That which is affixed to land;
3. That which is incidental or appurtenant to land;
4. That which is immovable by law; except that for the purposes of sale, emblements, industrial growing crops and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale, shall be treated as goods and be governed by the provisions of the title of this code regulating the sales of goods."

§659 provides:

“*Land.* Land is the solid material of the earth, whatever may be the ingredients of which it is composed, whether soil, rock, or other substance.”

§660 provides:

“*Definition of fixtures: severance by agreement.* A thing is deemed to be affixed to land when it is attached to it by roots, as in the case of trees, vines, or shrubs; . . .”

Thus it will be seen that California adopted the rule that *growing crops are a part of the “land”*, whatever the estate in land may be; and, further, ownership in land is the right of one or more persons to possession and use of it to the exclusion of others. The plaintiff at the time of this transaction had the right of exclusive possession and use, to the exclusion of others, of the properties in question; it therefore had an interest in the land which it could sell with the crops.

Decisions under the Revenue Act have held that the assignment of a leasehold estate is a sale, and is entitled under the Act to treatment as such.

In *Sutliff v. Commissioner*, 46 B.T.A. 466, Sutliff, holding a leasehold estate on property the fee of which was owned by his son, sold the lessor’s estate and the lessee’s estate to Avis. Sutliff, the lessee, reported the sale of his leasehold estate as a capital gain, which was challenged by the Commissioner. The Court stated:

“From the evidence before us we are unable to find that the petitioner cancelled his lease or that

the amount received by him from the sale of the property was anything other than consideration received by him through the sale of his leasehold interest."

And, further:

"The petitioner herein was not the owner of the fee, nor was the amount in controversy received by him from his lessee. After the sale of his lease he no longer owned any interest in the property."

And:

"The lease was an asset in the hands of the petitioner and, we think, comes within the definition of capital assets as contained in Section 117 of the applicable Act. Therefore, the gain realized by the petitioner from the sale of the lease was capital gain within the meaning of that section of the Act."

In *Golensky v. Commissioner*, 200 Fed. 2d 72, a tenant in possession for a consideration vacated and surrendered the premises before the date at which his lease expired, and the question was presented, was the consideration received for this surrender a "sale or exchange" so as to allow the tenant to pay income upon a capital gain under Section 117 of the Code, and the Court stated:

"After the tenant had transferred his lease to a third party at a profit, the resulting gain would be subject to capital gains treatment if other conditions were complied with."

And, further:

“Undoubtedly there is a cancellation of a lease when a tenant voluntarily surrenders the premises to a landlord in accordance with an agreement, but the fact that a cancellation occurs does not negative the fact that the transaction may constitute a sale. A lease is certainly property, although admittedly it is not an estate at freehold as that term was used in the Common Law. This property was transferred by the then owner to another for a stipulated price, which was paid. That would seem to constitute a sale unless there is some limiting requirement that nothing can be sold except a tangible chattel, which is not the case.”

And, further:

“If the transaction fits the legal requirements for a sale we see no reason for specific mention of it among a list classifying as a sale that which would not ordinarily be regarded as such a transaction.”

It is submitted that the Opinion of the Court is unrealistic in interpreting the Congressional intent in reading into those proceedings a condition not discussed. Nowhere in the Committee Reports or Congressional Debates is there is a reference to the character of an estate in land which was required as a prerequisite to capital gains on crops. The absence of such a discussion itself is persuasive, for certainly skilled senators and representatives must have been cognizant of the practice which has existed for centuries, dating back into the Common Law, of holding

land under leasehold tenure. It is safe to say that more land is farmed under lease tenure than under freehold, although the writer has no specific percentages at hand.

Yet Congress was concerned with sales of "unharvested crops" period, not "unharvested crops on fee land."

One further observation might be made in respect to the following portion of the Court's Opinion:

"It is my view that the phrase 'if the crop and the land are sold' clearly means the ownership of the land and does not mean 'if the crop and the right to the use of land are sold.'"

Yet the section is not limited to "sold." The section reads: "If the crop and the land are sold *or exchanged* . . . the crop shall be considered as property used in the trade or business."

By the transfer of the leases has not the right to use the land been exchanged? And the word "exchange" by no stretch of the imagination can be required to have the dignity of a specified form of tenure as a prerequisite to its effectiveness. Certainly the right and title to the crop and the right to the possession of the land was exchanged as a result of this transaction.

CONCLUSION.

It is therefore respectfully submitted that the Conclusions of Law and Judgment based upon the Findings of Fact are erroneous and that the Judgment should be entered in favor of plaintiff as prayed for.

Dated, Bakersfield, California,

June 24, 1958.

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